



Commonwealth of Massachusetts

Department of Revenue

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2002 Massachusetts Partnership Return **Form 3**

Schedule 3K-1 and Instructions

General Instructions

This booklet contains Form 3, Schedule 3K-1, and the instructions needed for completing your Massachusetts partnership return. The Massachusetts Schedule 3K-1 parallels federal Schedule K-1, which gathers information on each partner separately.

The instructions are divided into two sections designed to lead you through the form and answer your questions along the way.

The first section — **General Instructions** — answers commonly asked questions such as, “How Is a Partnership Taxed?”

The second section — **Specific Instructions** — provides information on each part of Form 3 and Schedule 3K-1.

What are the Major Tax Changes for 2002?

Tax Rate Lowered on Wages, Salaries, Interest, Dividends, and Certain Other Items of Income

Applicable to tax year 2002, legislation in 2000 resulting from a ballot initiative reduced the tax rate from 5.6% to 5.3% on the category of income consisting of wages, salaries, tips, pensions, Massachusetts bank interest, partnership income, business income, rents, alimony, winnings and certain other items of income.

Under current Massachusetts law, the tax rate on dividends and interest is the same as the tax rate on the category of income including wages, salaries, etc., that is more fully described above. Thus, the tax rate on dividends and interest is decreased from 5.6% to 5.3% for taxable year 2002. 12% income continues to include short-term capital gains, as well as short- and long-term capital gains arising from the sale of collectibles and gains on pre-1996 installment sales (a 50% deduction is allowed for gains on the sale of collectibles and gains on pre-1996 installment sales).

Tax Rate on Long-Term Capital Gains Increased for Transactions Completed On Or After May 1, 2002

Tax rates for transactions completed before May 1, 2002 Transactions completed prior to May 1, 2002 must be added together and taxed under the procedures and rates in place prior to the recent amendment to the capital gains law. Under prior law, gains on the sale of capital assets (excluding collectibles) held for more than one year but not more than two years are taxed as 5% income, those held for more than two years but not more than three years are taxed as 4% income, those held for more than three years but not more than four years are taxed as 3% income, those held for more than four years but not more than five years are taxed as 2% income, those held for more than five years but not more than six years are taxed as 1% income, and those held for more than six years are taxed as 0% income.

Tax rate for transactions completed on or after May 1, 2002 In place of the six categories of gain based on six defined holding periods and taxed at six different rates (ranging from 5% down to 0%), recent legislation provides for a single category of long-term capital gains consisting of any gains from the sale or exchange of capital assets (except collectibles) held for more than one year. Effective for tax years beginning on or after January 1, 2002, the legislation changes the multiple tax rates for long-term capital gains to the single tax rate of 5.3%, but only for transactions completed on or after May 1, 2002.

Limitation on Capital Loss Offset Against Schedule B Interest and Dividends

Under prior law, there was no dollar limit on the deduction of capital losses against Schedule B income consisting of interest and dividends. Under the new law, the total amount of deductions for short-term and long-term capital losses against Schedule B interest and dividends cannot exceed \$2,000.

Deduction for Charitable Contributions Suspended

Recent legislation disallows a deduction for charitable contributions for tax year 2002. Depending on economic conditions, a deduction for charitable contributions may become available in future tax years.

Massachusetts Depreciation Decoupled from Federal “Bonus” Depreciation Law

Massachusetts law was recently amended to decouple it from the adoption of Internal Revenue Code sec. 168(k). Section sec. 168(k) provides for a special depreciation allowance for certain property placed into service during the three-year period beginning on September 11, 2001. Under the Massachusetts law change, the new federal depreciation allowance is not allowed. For Massachusetts purposes, for taxable years ending after September 10, 2001, depreciation is to be claimed on all assets, regardless of when they are placed in service, using the method used for federal income tax purposes prior to the enactment of sec. 168(k). For more information, see TIR 02-11.

The U.S. Internal Revenue Code as of January 1, 1998

Massachusetts generally adopts the federal treatment of items of income and the federal exclusions from gross income. In addition, certain deductions allowed for federal tax purposes are allowed for Massachusetts tax purposes. With certain exceptions, Massachusetts now adopts the Internal Revenue Code as amended and in effect on January 1, 1998. The exceptions, which will be treated according to the current Internal Revenue Code, are listed below. See TIR 98-15 for an explanation of the major changes to the Massachusetts personal income tax provisions as a result of the adoption of the January 1, 1998 Internal Revenue Code.

Federal Law Changes NOT Adopted by Massachusetts

► **Employer-Provided Educational Assistance — IRC sec. 127.** Educational benefits qualified for exclusion from federal gross income under IRC sec. 127 are included in Massachusetts gross income in 2002. The Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. 107-16, June 7, 2001, expanded the benefits of the federal exclusion at sec. 127, but Massachusetts has not adopted the new federal changes. Massachusetts adopts the provisions of IRC sec. 127, as in effect on January 1, 1998, which provide an exclusion from gross income for certain employer-provided education assistance for undergraduate courses, but the exclusion does not apply to payments for any course that began after May 31, 2000.

► **Parking, T-Pass and Vanpool Fringe Benefits — IRC sec. 132(f).** Generally, Massachusetts follows the exclusion from an employee's gross income for employer-provided parking, T-Pass, and vanpool benefits. However, a federal Act subsequent to January 1, 1998, created differences between the Massachusetts and federal

treatment of this exclusion. These differences will be reflected in the Form W-2 provided by your employer. See TIR 02-8.

► **Self-Employed Health Insurance Deduction — IRC sec. 162(l).** A federal and Massachusetts deduction is allowed for amounts paid for medical care insurance for a self-employed taxpayer and his or her spouse and dependents. For federal purposes the deduction will be 70% of the qualified insurance payments for the 2002 tax year. However, due to differences between the Internal Revenue Code, as amended and in effect as of January 1, 1998, and the current year, only 60% of the qualified insurance payments are deductible for Massachusetts purposes for the 2002 tax year.

Massachusetts Adopts the Current Internal Revenue Code for Certain Federal Tax Provisions.

► **Employee Retirement Plans.** Beginning with tax year 2002, Massachusetts conforms to current federal law governing the taxation of contributions to and distributions from qualified plans, sec. 401(k) plans, sec. 403(b) plans, sec. 457 plans, SEPs (simplified employee pensions), and SIMPLE IRAs (savings incentive match plans for employees). Prior to 2002, for these retirement plans, Massachusetts generally followed the IRC as amended and in effect on January 1, 1998. Under the new law, Massachusetts conforms to current federal law in the treatment of elective deferrals, catch-up contributions, and qualified rollovers of plan proceeds. All amounts of retirement plan contributions and distributions that are allowed to be excluded from federal gross income under the current IRC will be excluded from Massachusetts gross income.

► **Employer Contributions To Retirement Plans.** Beginning with tax year 2002, in the case of employers taxed under chapter 62 of the General Laws, unless a specific statutory exception applies (see, e.g., G.L. c. 62, sec. 2(d)(1)(D)), Massachusetts adopts the current federal law at IRC sec. 404 allowing the deduction of employer contributions to qualified plans and other retirement plans.

Other areas in which Massachusetts applies the current Internal Revenue Code consist of:

- deduction of trade or business expenses under IRC sec. 162(a); and
- the limitations provided by IRC secs. 274(m) and (n) for the deduction of certain travel and meals and entertainment expenses.

For the above items, Massachusetts automatically adopts all changes to the Internal Revenue Code, including changes made after January 1, 1998. For more information, see TIR 98-8, TIR 98-15 and 02-18.

When Must a Partnership File a Return?

A Massachusetts partnership return, Form 3, must be filed if the partnership meets either of the following criteria:

- has a usual place of business in Massachusetts; or
- receives federal gross income of more than \$100 during the taxable year.

How Is a Partnership Taxed?

A partnership is not directly subject to income tax. Instead, each partner is taxed on the partner's share of the partnership income, whether distributed or not. Form 3 is a legally required informational return under Massachusetts General Laws, Ch. 62C, and subject to penalty for late filing.

How Does Schedule 3K-1 Work?

Schedule 3K-1 is designed to allow the partnership to report each partner's distributive share of partnership income separately.

Can Schedule 3K-1 Be Filed in an Alternative Format?

The Massachusetts Department of Revenue is now accepting Schedule 3K-1 by diskette. Form 3, however, must still be filed on paper. For a copy of the General Diskette Specifications and Record Layouts, you may visit the Department's website at www.mass.gov/dor.

How Does Each Partner Report Partnership Income?

Each partner must report the partner's distributive share of each item of partnership income during the taxable year on the partner's Massachusetts tax return. The following table shows which return should be filed by each type of partner:

<i>Type of partner</i>	<i>Form to file</i>
<i>Full-year resident individual</i>	<i>1</i>
<i>Nonresident/part-year resident individual</i>	<i>1-NR/PY</i>
<i>Trust or estate</i>	<i>2</i>
<i>Domestic or foreign corporation</i>	<i>355</i>
<i>Domestic or foreign corporation</i> <i>(part of a Massachusetts combined group)</i>	<i>355C</i>
<i>Domestic or foreign S corporation</i>	<i>355S</i>
<i>Corporate trust</i>	<i>3F</i>

Each **nonresident partner** must report the partner's distributive share of partnership income from any of the following categories:

- income derived from or connected with the partnership business carried on in Massachusetts;
- income from the ownership of any interest in real or tangible personal property located in Massachusetts; or
- interest, dividends, annuities and capital gains from property employed in the partnership business carried on in Massachusetts.

Note: A nonresident limited partner of a limited partnership engaged exclusively in buying, selling, dealing in or holding securities on its own behalf and not as a broker is not subject to tax on income from such partnership.

Qualified electing nonresident partners may file a composite tax return as defined in the Nonresident Regulation 830 CMR 62.5A.1(12)(f). A composite return is made on a Form 1-NR/PY with a composite Schedule E attached.

What is Massachusetts Gross Income?

Massachusetts Gross Income is divided into three classes: Part B is taxed at 5.3%, Part A is taxed at 5.3% and 12% and Part C is taxed at 5%, 4%, 3%, 2%, 1% or 5.3%.

Part B income:

- Gross receipts from sales;
- Ordinary income or loss from other partnerships excluding all interest (other than interest from Massachusetts banks) and dividends;
- Ordinary income or loss from trusts and estates not subject to Massachusetts taxation;
- Royalty income or loss;

- Income from REMIC residual interest;
- Rental income or loss;
- Massachusetts bank interest; and
- Other income taxed at 5.3% (see Form 1 instructions).

Part A income:

- Interest other than from Massachusetts banks (taxed at 5.3%);
- Dividends (taxed at 5.3%);
- Short-term capital gains and losses (taxed at 12%);
- Gains and losses on the sale, exchange or involuntary conversion of property used in a trade or business and held for one year or less (taxed at 12%); and
- Long-term gains on collectibles and pre-1996 installment sales classified as capital gain income for Mass. purposes (taxed at 12%).

Part C income:

- Long-term capital gains and losses excluding long-term gains on collectibles; and
- Losses on the sale, exchange or involuntary conversion of property used in a trade or business and held for more than one year.

Note: Massachusetts gross income does **not** include interest on obligations of the U.S. or Mass. and its political sub-divisions.

Are There Differences Between Massachusetts Tax Law and the Internal Revenue Code Provisions Affecting Partnerships?

Yes. There are a number of differences between Massachusetts and U.S. personal income tax law. For Massachusetts tax purposes, a partnership is allowed only those expense deductions that an individually owned business is allowed. Deductions that are itemized by an individual on Schedule A of U.S. Form 1040 are not allowed. The deduction for a net operating loss carryover or carryback is not allowed to the partnership nor to an individual under Massachusetts income tax law. Explanations of these differences are provided in the appropriate lines and in the Forms 1 and 1-NR/PY instructions.

Massachusetts depreciation has been decoupled from the federal "bonus" depreciation law. For Massachusetts purposes, for taxable years ending after September 10, 2001, depreciation is to be claimed on all assets, regardless of when they are placed in service, using the method used for federal income tax purposes prior to the enactment of sec. 168(k). For more information see TIR 02-11.

Form 3 and Schedule 3K-1 isolate income and deduction items in order to produce the correct Massachusetts partnership total as well as each partner's correct Massachusetts distributive share. These amounts sometimes differ from those reported on U.S. Form 1065, Schedule K-1.

When and Where Must a Partnership Return Be Filed?

A partnership return is due on or before the 15th day of the fourth month after the close of the partnership's taxable year, calendar or fiscal. If the partnership was dissolved or reorganized during the taxable year, Form 3 must be filed to reflect partnership activity as of the date of dissolution or reorganization.

Form 3 must be signed by one of the general partners. U.S. Form 1065 or Form 1065-B and all related schedules, including Schedule K-1 must be attached. A return without attached U.S. information is incomplete and subject to penalty.

The Massachusetts Department of Revenue is now accepting Schedule 3K-1 by diskette. Form 3, however, must still be filed on paper. For a copy of the General Diskette Specifications and Record Layouts, visit the Department's website at www.mass.gov/dor.

Mail partnership return to:
Massachusetts Department of Revenue
PO Box 7017
Boston, MA 02204

What is the Penalty for Filing a Late Return?

A \$5.00 per day penalty may be imposed for failure to file a partnership return on time.

Specific Instructions

Certain lines are addressed in detail. Those lines without specific instructions are considered to be self-explanatory.

The Department of Revenue and the Internal Revenue Service maintain an extensive exchange program routinely sharing computer tapes and audit results. Discrepancies between income and deductions reported federally and on this return, except those allowed under state law, will be identified and may result in a state audit or further investigation.

Electing Large Partnerships

If a partnership is filing U.S. Form 1065-B, U.S. Return of Income for Electing Large Partnerships, enter amounts from the lines on Form 1065-B corresponding to the line references from U.S. Form 1065. If there is no equivalent U.S. Form 1065-B line reference, enter the requested amount as if it had been reported on U.S. Form 1065.

Part II. Partnership Income

If a partnership is made up entirely of **corporate partners**, the partnership need not complete Form 3, Part II. The partnership, however, must complete Form 3, Part I and, if applicable, Part III, and Schedule 3K-1, lines 22 through 29 (see instructions for Income Apportionment, Part III). The partnership must also attach U.S. Form 1065 and all schedules, including K-1s.

Massachusetts Ordinary Income or Loss

Line 1. Ordinary Income or Loss

Enter the total amount of ordinary income or loss from U.S. Form 1065, line 22.

Line 2. Other Income or Loss

If reporting other income or loss from U.S. Form 1065, Schedule K, line 7, attach a statement and explain. If any income or loss from U.S. Form 1065, Schedule K, line 7 is granted capital gains treatment by the federal government, omit it here and include it in lines 18 through 23, as applicable.

Line 3. State, Local and Foreign Income and Unincorporated Business Taxes or Excises

Enter total state, local and foreign income and unincorporated business taxes or excises. These taxes are deductible for U.S. tax purposes, but are not deductible in Massachusetts.

Line 5. Section 1231 Gains or Losses

Enter any gains or losses from the sale, exchange or involuntary conversion of Section 1231 property included in line 4 above. These amounts should be included in lines 20, 21 and 23 as applicable.

Line 7. Other Adjustments

Report and describe any other adjustments to Massachusetts partnership income and deductions not reported elsewhere on Form 3.

For Massachusetts tax purposes, a partnership is allowed only those expense deductions that an individually owned business is allowed. Deductions that are itemized by an individual on Schedule A of U.S. Form 1040, are not allowed. The deduction for a net operating loss carryover or carryback is not allowed to the partnership nor to an individual under Massachusetts income tax law.

Massachusetts depreciation has been decoupled from the federal "bonus" depreciation law. For Massachusetts purposes, for taxable years ending after September 10, 2001, depreciation is to be claimed on all assets, regardless of when they are placed in service, using the method used for federal income tax purposes prior to the enactment of sec. 168(k). For more information see TIR 02-11. The partnership should provide each partner with the amount of the partner's share of the difference between the Massachusetts depreciation allowance and the federal "bonus" depreciation allowance.

Also report the deductions for 10% of the costs of renovating a qualifying abandoned building located in an Economic Opportunity Area. Attach a statement detailing the location and cost of renovating the qualifying abandoned building. The building must be designated as abandoned by the Economic Assistance Coordinating Council. For further information, contact the Massachusetts Office of Business Development, One Ashburton Place, Room 2101, Boston, MA 02108.

The partnership should also provide each partner with the amount of the partner's share of the deductible costs of renovating a qualifying abandoned building. Each partner should use this amount to complete Forms 1 or 1-NR/PY, Schedule E, Part II, line 4; Form 2; or Form 3F.

Line 9. Net Income or Loss from Rental Real Estate Activity(ies)

Enter the net income or loss from rental real estate activity(ies) from U.S. Form 1065, Schedule K, line 2.

Line 10. Net Income or Loss from Other Rental Activity(ies)

Enter the net income or loss from other rental activity(ies) from U.S. Form 1065, Schedule K, line 3c.

U.S. Portfolio Income

Line 11. U.S. Portfolio Income, Not Including Capital Gains

Add U.S. Form 1065, Schedule K, lines 4a, 4b, 4c and 4f and enter the total in line 11.

Line 12. Interest on U.S. Debt Obligations

Enter the total amount of interest on U.S. debt obligations reported in line 11 which is taxable by the federal government, but is tax-exempt in Massachusetts.

Line 13. 5.3% Interest from Massachusetts Banks

Enter the total amount of interest from Massachusetts banks included in line 11. Report any interest from Mass. savings accounts, savings share accounts and NOW accounts. Also report any interest from term and time deposits. Attach a statement listing bank sources and amounts.

Line 14. Interest and Dividend Income

Enter the total amount of interest (other than interest from Massachusetts banks) and dividend income included in line 11. Do not include interest on U.S. debt obligations, which is taxable by the federal government, but is tax-exempt in Massachusetts. Attach a statement listing sources and amounts.

Line 15. Non-Massachusetts State and Municipal Bond Interest

Enter the total amount of the partnership's non-Massachusetts state and municipal bond interest. This interest is taxable in Massachusetts, but not taxed by the federal government and thus not reported on U.S. Form 1065, Schedule K, line 4a.

Line 16. Royalty Income

Enter the total amount of royalty income included in line 11.

Line 17. Other Income

Enter the total amount of other income included in line 11 (from U.S. Form 1065, Schedule K, line 4f).

Massachusetts Capital Gains and Losses

If the partnership had any other income or loss that is granted capital gains treatment by the federal government, include that amount in lines 18 through 24, as applicable.

Line 18. Total Short-Term Capital Gains

Enter the total amount of short-term capital gains included in U.S. Form 1065, Schedule D, line 5.

Line 19. Total Short-Term Capital Losses

Enter the total amount of short-term capital losses included in U.S. Form 1065, Schedule D, line 5.

Line 20. Gain On the Sale, Exchange or Involuntary Conversion of Property Used in a Trade or Business and Held for One Year or Less

Enter from U.S. Form 4797 the amount of gain from the sale, exchange or involuntary conversion of property used in a trade or business and held for one year or less.

Line 21. Loss On the Sale, Exchange or Involuntary Conversion of Property Used in a Trade or Business and Held for One Year or Less

Enter from U.S. Form 4797 the amount of loss from the sale, exchange or involuntary conversion of property used in a trade or business and held for one year or less.

Line 22. Net Long-Term Capital Gain or Loss

Enter the net long-term gain or loss from U.S. Form 1065, Schedule K, line 4e(2).

Line 23. Long-Term Section 1231 Gains and Losses

Enter the amount of gain or loss under IRC Section 1231 from U.S. Form 1065, Schedule K, line 6 from property held more than one year. Also, include any amounts included in U.S. Form 4797, Part II treated as capital gains or losses for Massachusetts purposes.

Line 24. Long-Term Gains on Collectibles and Pre-1996 Installment Sales

Enter the amount of any long-term gain from collectibles held for more than one year and pre-1996 installment sales classified as capital gain income for Massachusetts purposes.

Collectibles are defined as any capital asset that is a collectible within the meaning of Internal Revenue Code section 408(m), as amended and in effect for the taxable year, including works of art, rugs, antiques, metals, gems, stamps, alcoholic beverages, certain coins, and any other items treated as collectibles for federal tax purposes.

Line 25. Differences and Adjustments

Report any adjustments to Massachusetts capital gains and losses. Attach a complete statement explaining any such adjustments. For more information see Form 1, Schedule D instructions.

Part III. Income Apportionment

Part III should be completed only if **all** three of the following conditions are met: (a) there is one or more corporate or nonresident individual partners; (b) there is any income from business activity or ownership of any interest in real or tangible property in another state; (c) such business activities provide the other state the jurisdiction to levy an income or franchise tax.

The total partnership income is apportioned using the three-factor formula provided in Massachusetts General Laws Ch. 63, sec. 38(c), except that the sales factor is single-weighted.

The partnership should provide each corporate partner or corporate trust partner with the applicable apportionment factors to be used in completing Schedule F of the applicable corporate form, or Form 3F, Schedule E.

Line 26. Tangible Property

26a. For tax purposes, average value is based on original cost and is determined by averaging the property values at the beginning and end of the taxable year. If substantial changes occur during the taxable year, the Commissioner may require monthly averaging to properly reflect the average value of the property.

26b. Property rented is valued at eight times the annual rental rate less any sub-rentals received.

Line 27. Payroll

Enter the total amount of wages, salaries, commissions or any other compensation paid to employees. An employee's compensation is apportioned to Massachusetts if **any** of the following apply:

- The employee's service is performed within Massachusetts;
- The employee's service is performed both in Massachusetts and in other state(s), but the non-Massachusetts service is secondary to the Massachusetts service;
- Part of the employee's service is performed in Massachusetts, and the service is controlled from a base of operations/place of control in Massachusetts; or
- Part of the employee's service is performed in Massachusetts and the base of operations/place of control of the service is not in a state in which some part of the service is performed, but the employee lives in Massachusetts.

Line 28. Sales

For the sales factor, enter all gross receipts of the partnership with the exception of those receipts from interest, dividends and the sale or other disposition of securities.

28a. Sales of tangible personal property are assignable to Massachusetts if:

- The property is delivered or shipped to any buyer, including the U.S. Government, in Massachusetts; or
- The selling partnership is not taxable in the state of the buyer and the property is not sold by an agent or agencies chiefly situated at, connected with, or sent out from premises for the transaction of business owned or rented by the partnership outside Massachusetts. A buyer for this item includes the U.S. Government.

Sales of tangible personal property are **not** assignable to Massachusetts if:

- The property is shipped or delivered to a buyer in a foreign country; or
- The property is sold to any branch or instrumentality of the U.S. Government for resale to a foreign government.

28b. Sales of services, or other intangibles, are assigned to Massachusetts if the income-producing activity is performed in Massachusetts, or if the greater portion of the activity occurs in Massachusetts than in any other state based on performance cost.

28c. Rents from property located or used in Massachusetts are assigned to Massachusetts. Royalties are assigned to the state in which the property right is actually used by the lessee.

Line 30. Massachusetts Apportionment Percentage

Any apportionment factor should not necessarily be considered inapplicable if its Massachusetts total (column A, lines 26c, 27a or 28e) is zero. If any of the apportionment totals for "Everywhere" (column B, lines 26c, 27a or 28e) are less than 3.33% of taxable net income, **do not** include that factor in your Massachusetts apportionment percentage.

Divide the total apportionment percentage in line 29 by either 3, 2 or 1, depending on the number of apportionment factors which apply. For example, if only the sales and payroll factors are applicable, divide by 2 instead of 3.

Lines 31 through 35. Resident and Nonresident Reconciliation

The Massachusetts apportionment percentage (line 30) is applied only to the nonresident partners' share of each major income item. The total resident partners' shares are then added to reach the total amount of resident and nonresident partners' income attributable to Massachusetts. Finally, the corporate partners' share of each major income item is reported.

When completing line 32 exclude any income from unrelated business activities prior to apportionment, see 830 CMR 63.38.1, sections (3) and (4). Attach a statement and explain any adjustments.

Schedule 3K-1. Partner's Massachusetts Information

Partner's Distributive Share

A partner's distributive share of any item of income, loss, deduction or credit shall be determined by the partnership agreement. If the partnership agreement contains no special provisions with respect to the partner's distributive share of any item of income, loss, deduction or credit, such item shall be prorated in accordance with each partner's ratio of sharing income or losses of the partnership.

a. For a corporate partner skip to line 22.

b. For a nonresident partner eligible to apportion, enter in column B, lines 1 through 8 and 10 through 21, the amount of the partner's share of each applicable distributive share item multiplied by the apportionment percentage in Form 3, line 30.

Income should be apportioned if:

- There is one or more nonresident individual partners **and**;
- There is any income from business activity or ownership of any interest in real or tangible property in another state **and**;

- Such business activities provide the other state the jurisdiction to levy any income or franchise tax.

Note: For line 9, however, enter in column B the amount of the nonresident partner's distributive share without apportionment. For line 2, see instructions.

c. For all other partners, enter in column B, lines 1 through 21, the amount of the partner's share of each applicable distributive share item.

d. For lines 18 through 20 the partnership may provide each partner with a written breakdown of long-term capital gains and losses from transactions completed prior to May 1, 2002 by the applicable holding periods of: more than one year but not more than two years; more than two years but not more than three years, more than three years but not more than four years; more than four years but not more than five years; more than five years but not more than six years; and more than six years.

e. A common trust fund under IRC Section 584 which has long-term capital gains and long-term capital losses must adjust the amount of capital gain reported to the partners.

First, gains and losses within each holding period are netted. For example, 5% gains are applied against 5% losses, 4% gains are applied against 4% losses, 3% gains are applied against 3% losses, 2% gains are applied against 2% losses, 1% gains are applied against 1% losses, 0% gains are applied against 0% losses and 5.3% gains are applied against 5.3% losses. Then, any net losses within a particular holding period can be applied against net gains within other holding periods, beginning with the 5% tax rate and applying any remaining losses against the next succeeding tax rate. For example, a 3% loss is first applied to 5% gains, any remaining loss is applied to 4% gains, any remaining loss is applied against 2% gains, any remaining loss then is applied against 1% gains, any remaining loss then is applied against 0% gains, and any loss still remaining then is applied against 5.3% gains.

The excess, if any, of each class's net capital loss, reduced by any amount of such capital loss applied against other classes' net capital gain, shall be a capital loss in the succeeding taxable year.

Line 1. Massachusetts Ordinary Income or Loss

Enter the amount of the partner's share of the partnership's Massachusetts ordinary income or loss from Form 3, line 8. For a nonresident partner eligible to apportion, enter the amount of the partner's share of the partnership's Massachusetts ordinary income or loss multiplied by the apportionment percentage in Form 3, line 30.

Line 2. Guaranteed Payments to Partners (Deductible and Capitalized)

Enter the guaranteed payments to each partner from U.S. Form 1065, Schedule K, line 5. For a nonresident partner eligible to apportion, if the payments are for services, the partnership should not apportion using the partnership's apportionment percentage, but should report payments related to services performed in Massachusetts. If the payments are not for services, use the partnership's Massachusetts apportionment percentage.

Line 3. Separately Stated Deductions and Exclusions

Report and describe in line 3 any other expense that is deductible from income taxed at 5.3% and properly reportable on Massachusetts Forms 1 or 1-NR/PY, Schedule E, Part II; or Forms 2 or 3F, and that is not reported elsewhere on Schedule 3K-1. Examples of such

deductions include oil and gas depletion and the expense deduction for recovery property, IRC Section 179. An estate or trust may not elect to expense recovery property. Report and describe in line 3 the partner's elective contribution to a qualified CODA retirement plan. Each partner should report this amount in Forms 1 or 1-NR/PY, Schedule E, Part II, line 2. A partner's distributive share of the federal deduction for any matching contribution made by the partnership is not deductible in Massachusetts. See DOR Directive 01-7.

Line 4. Total of Lines 1, 2 and 3

Combine the amounts in lines 1, 2 and 3. The line 4 result includes each partner's share of the partnership's Massachusetts ordinary income and any guaranteed payments to the partner (deductible and capitalized).

The correct Massachusetts amount of the partner's share of ordinary income and guaranteed payments may differ from the comparable U.S. total reported on the partner's Form 1 or 1-NR/PY, Schedule E, Part II, line 1; Form 2, line 17; or Form 3F. Each partner should make adjustments in Form 1 or 1-NR/PY, Schedule E, Part II, line 2 and line 4, if applicable; Form 2, line 17; or Form 3F, to reflect the correct Massachusetts amount. Each partner should attach a statement with the partner's Massachusetts tax return and explain.

The partnership should provide each partner with the amount of the partner's share of any interest (other than interest from Massachusetts banks) and dividend income and 5.6% interest from Massachusetts banks included in line 4. Each partner should use these amounts to complete Form 1 or 1-NR/PY, Schedule E, Part II, lines 6 and 7; Form 2; or Form 3F.

Line 5. Credits

Income Tax Paid to Other Jurisdictions

Enter the partner's share of any tax due from the partnership to any other state, territory or possession of the United States, or the Dominion of Canada or any of its provinces on income taxable to the partner in Massachusetts and otherwise allowable as a credit to the individual. The partnership should also provide each such partner with the names of each taxing jurisdiction and the amount taxed.

This credit is available only to resident partners and may be taken on Form 1, line 29, Form 1-NY/PY, line 34 or where applicable, on Form 2, line 43. Where the credit is available, the partnership must also provide each resident partner with separately stated totals of 5.3%, 12%, 5, 4%, 3%, 2% and 1% income taxed by other jurisdictions to enable the partners to complete Schedule F.

Note: The amount in line 5 is **not** simply the partner's share of the amount reported on Form 3, line 3, because the credit for taxes paid to other jurisdictions does not include local income taxes paid or taxes paid to nations other than Canada.

Lead Paint Credit

Enter the partner's share of any credit due to the partnership for expenses incurred by the partnership for covering or removing lead paint on residential premises in Massachusetts. The partnership must provide each partner with a copy of a "Letter of Compliance" or a "Letter of Interim Control" issued by a licensed inspector.

Economic Opportunity Area Credit

Enter the partner's share of any Economic Opportunity Area Credit for qualifying property used in a Certified Project. Enter each partner's share of the credit, according to the partner's ownership share in line 5 of each partner's Schedule 3K-1.

This amount should then be used by each partner to complete Schedule EOA.

Full Employment Credit

Enter the partner's share of any Full Employment Credit, according to the partner's ownership share in line 5 of each partner's Schedule 3K-1.

This amount should then be used by each partner to complete Schedule FEC.

Brownfields Credit

Enter the partner's share of any Brownfields Credit, according to the partner's ownership share in line 5 of each partner's Schedule 3K-1.

This amount should then be used by each partner to complete Schedule BC.

Low-Income Housing Credit

Enter the partner's share of any Low-Income Housing Credit, according to the partner's ownership share in line 5 of each partner's Schedule 3K-1. A copy of the Eligibility Statement issued by the Department of Housing and Community Development must be attached to each partner's Schedule 3K-1.

This amount should then be used by each partner to complete their return.

For further information regarding this credit, contact the Department of Housing and Community Development, Division of Private Housing, at (617) 727-7827.

Credit Recapture

If the partnership is required to recapture any Economic Opportunity Area Credit, Brownfields Credit or Low-Income Housing Credit, enter the partner's share of any recapture as computed on Schedule H-2. This amount should then be used by each partner to complete their return.

Line 6. Net Income or Loss from Rental Real Estate Activity(ies)

Enter the partner's share of the partnership's net rental income or loss from real estate activity(ies) from Form 3, line 9.

The correct Massachusetts amount of the partner's share of net income or loss from rental real estate activity(ies) may differ from the comparable U.S. total reported on the partner's Form 1 or 1-NR/PY, Schedule E, Part II, line 1; Form 2, Schedule E, line 1; or Form 3F. Each partner should make adjustments in Form 1 or 1-NR/PY, Schedule E, Part II, line 2; Form 2, Schedule E, line 2; or Form 3F, to reflect the correct Massachusetts amount. Each partner should attach a statement with the partner's Massachusetts tax return and explain.

Line 7. Net Income or Loss from Other Rental Activity(ies)

Enter the partner's share of the partnership's net rental income or loss from other activity(ies) from Form 3, line 10.

The correct Massachusetts amount of the partner's share of net rental income or loss from other activity(ies) may differ from the comparable U.S. total reported on the partner's Form 1 or 1-NR/PY, Schedule E, Part II, line 1; Form 2, line 17; or Form 3F. Each partner should make adjustments in Form 1 or 1-NR/PY, Schedule E, Part II, line 2; Form 2, line 17; or Form 3F, to reflect the correct Massachusetts amount. Each partner should attach a statement with the partner's Massachusetts tax return and explain.

Line 8. 5.3% Interest from Massachusetts Banks

Enter the partner's share of the partnership's 5.3% interest from Massachusetts banks from Form 3, line 13. For a nonresident partner eligible to apportion, enter the partner's share of the partnership's 5.3% interest from Massachusetts banks multiplied by the apportionment percentage in Form 3, line 30.

Each partner should include the line 8 total in Form 1, line 5; Form 1-NR/PY, line 7; Form 2, line 16 or Form 3F.

Each nonresident partner whose income is apportioned should receive from the partnership the amount of the partner's pre-apportionment share of 5.3% interest from Massachusetts banks. Each nonresident individual whose income is apportioned should include this amount in Form 1-NR/PY, Schedule B, line 5. This amount should be used instead of any amount from Form 1-NR/PY, line 7 because the partner's full distributive share of such income is included in the U.S. amount reported in Schedule B, line 1. Each nonresident trust or estate whose income is apportioned should include its pre-apportionment share of 5.3% interest from Massachusetts banks in Form 2, Schedule B, line 6, instead of any amount from Form 2, line 16.

Line 9. Interest on U.S. Debt Obligations

Enter the partner's share of the partnership's interest on U.S. debt obligations from Form 3, line 12. For a nonresident partner eligible to apportion, enter the partner's share **without** apportionment. This income is taxable by the federal government, but tax-exempt in Massachusetts.

Each partner should include the line 9 total in Form 1 or 1-NR/PY, Schedule B, line 6; Form 2, Schedule B, line 5; or Form 3F, Schedule B, line 7.

Line 10. Non-Massachusetts State and Municipal Bond Interest

Enter the partner's share of the partnership's non-Massachusetts state and municipal bond interest from Form 3, line 15. For a nonresident partner eligible to apportion, enter the partner's distributive share of the partnership's non-Massachusetts state and municipal bond interest multiplied by the apportionment percentage in Form 3, line 30. This income is not taxed by the federal government, but **is** taxable in Massachusetts.

Each partner should include the line 10 total in Form 1, 1-NR/PY, 2 or 3F, Schedule B, line 3.

Line 11. Interest and Dividend Income

Enter the partner's share of the partnership's interest (other than interest from Massachusetts banks) and dividend income from Form 3, line 14. For a nonresident partner eligible to apportion, enter the partner's distributive share of the partnership's interest (other than interest from Massachusetts banks) and dividend income multiplied by the apportionment percentage in Form 3, line 30.

The correct Massachusetts amount of the partner's share of interest (other than interest from Massachusetts banks) and dividend income may differ from the comparable U.S. total reported on the partner's Form 1, 1-NR/PY or 2, Schedule B, lines 1 and 2; or Form 3F. Each partner should make adjustments in Form 1 or 1-NR/PY, Schedule B, line 6; Form 2, Schedule B, line 8; or Form 3F, Schedule B, line 7 to reflect the correct Massachusetts amount. Each partner should attach a statement with the partner's Massachusetts tax return and explain.

Line 12. Royalty Income

Enter the partner's share of the partnership's royalty income from Form 3, line 16.

For a nonresident partner eligible to apportion, enter the partner's distributive share of the partnership's royalty income from Form 3, line 16 multiplied by the apportionment percentage in Form 3, line 30.

The correct Massachusetts amount of the partner's share of royalty income may differ from the comparable U.S. total reported on Form 1 or 1-NR/PY, Schedule E, Part I, line 1a; Form 2, Schedule E, line 1a; or Form 3F. Each partner should make adjustments in Form 1, 1-NR/PY, Schedule E, Part I, line 2; or Form 2, Schedule E, line 2; or Form 3F, to reflect the correct Massachusetts amount. Each partner should attach a statement with the partner's Massachusetts tax return and explain.

Line 13. Other Income

Enter the partner's share of the partnership's other income from Form 3, line 17. For a nonresident partner eligible to apportion, enter the partner's distributive share of the partnership's other income from Form 3, line 17 multiplied by the apportionment percentage in Form 3, line 30.

The correct Massachusetts amount of the partner's share of other income may differ from the comparable U.S. total reported on Form 1, 1-NR/PY, 2 or 3F. Each partner should make adjustments on the applicable lines of Form 1, 1-NR/PY, 2 or 3F, to reflect the correct Massachusetts amount. If any income reported to the partnership from a Real Estate Mortgage Investment Conduit (REMIC), in which the partnership is a residual interest holder, is reported in line 17, then any such adjustment should be made on Form 1 or 1-NR/PY, Schedule E, Part I, line 1b or Form 2, Schedule E, line 1b.

Line 14. Short-Term Capital Gains

Enter the partner's share of the partnership's short-term capital gain from Form 3, line 18. For a nonresident partner eligible to apportion, enter the partner's share of the partnership's short-term capital gain multiplied by the apportionment percentage in Form 3, line 30.

The correct Massachusetts amount of the partner's share of short-term capital gain may differ from the comparable U.S. total reported on your Form 1, 1-NR/PY, 2 or 3F, Schedule B. Each partner should make adjustments in Form 1 or 1-NR/PY, Schedule B, line 10, or Form 2, Schedule B, line 13 or Form 3F, Schedule B, line 12, to reflect the correct Massachusetts amount. Each partner should attach a statement with the partner's Massachusetts tax return and explain any adjustments.

Line 15. Short-Term Capital Losses

Enter the partner's share of the partnership's short-term capital loss from Form 3, line 19. For a nonresident partner eligible to apportion, enter the partner's share of the partnership's short-term capital loss multiplied by the apportionment percentage in Form 3, line 30.

The correct Massachusetts amount of the partner's share of short-term capital loss may differ from the comparable U.S. total reported on your Form 1, 1-NR/PY, 2 or Form 3F, Schedule B. Each partner should make adjustments in Form 1 or 1-NR/PY, Schedule B, line 16, or Form 2, Schedule B, line 19 or Form 3F, Schedule B, line 18, to reflect the correct Massachusetts amount. Each partner should attach a statement with the partner's Massachusetts tax return and explain any adjustments.

Line 16. Gain on the Sale, Exchange or Involuntary Conversion of Property Used in a Trade or Business and Held for One Year or Less

Enter the partner's share of the partnership's gain on the sale, exchange or involuntary conversion of property used in a trade or business and held for one year or less from Form 3, line 20. For a nonresident partner eligible to apportion, enter the partner's share of the partnership's gain on the sale, exchange or involuntary conversion of property used in a trade or business and held for one year or less multiplied by the apportionment percentage in Form 3, line 30.

The correct Massachusetts amount of the partner's share of gain on the sale, exchange or involuntary conversion of property used in a trade or business and held for one year or less may differ from the comparable U.S. total reported on your Form 1, 1-NR/PY, 2 or 3F, Schedule B. Each partner should make adjustments in Form 1 or 1-NR/PY, Schedule B, line 12, or Form 2, Schedule B, line 15 or Form 3F, Schedule B, line 14, to reflect the correct Massachusetts amount. Each partner should attach a statement with the partner's Massachusetts tax return and explain any adjustments.

Line 17. Loss on the Sale, Exchange or Involuntary Conversion of Property Used in a Trade or Business and Held for One Year or Less

Enter the partner's share of the partnership's loss on the sale, exchange or involuntary conversion of property used in a trade or business and held for one year or less from Form 3, line 21. For a nonresident partner eligible to apportion, enter the partner's share of the partnership's loss on the sale, exchange or involuntary conversion of property used in a trade or business and held for one year or less multiplied by the apportionment percentage in Form 3, line 30.

The correct Massachusetts amount of the partner's share of loss on the sale, exchange or involuntary conversion of property used in a trade or business and held for one year or less may differ from the comparable U.S. total reported on your Form 1, 1-NR/PY, 2 or 3F, Schedule B. Each partner should make adjustments in Form 1 or 1-NR/PY, Schedule B, line 17, or Form 2, Schedule B, line 20 or Form 3F, Schedule B, line 19, to reflect the correct Massachusetts amount. Each partner should attach a statement with the partner's Massachusetts tax return and explain any adjustments.

Line 18. Long-Term Capital Gain or Loss

Enter the partner's share of the partnership's long-term capital gain or loss from Form 3, line 22. For a nonresident partner eligible to apportion, enter the partner's share of the partnership's long-term capital gain or loss multiplied by the apportionment percentage in Form 3, line 30.

The correct Massachusetts amount of the partner's share of long-term capital gain or loss may differ from the comparable U.S. total reported on your Form 1, 1-NR/PY, 2 or 3F, Schedule D. Each partner should make adjustments in Form 1 or 1-NR/PY, Schedule D, Part 1, line 9 or Part 2, line 8, or Form 2, Schedule D, line 11 or Form 3F, Schedule D, line 6, to reflect the correct Massachusetts amount. Each partner should attach a statement with the partner's Massachusetts tax return and explain any adjustments.

Line 19. Long-Term Section 1231 Gains or Losses

Enter the partner's share of the partnership's long-term section 1231 gain or loss (not included in line 18) from Form 3, line 23. For a nonresident partner eligible to apportion, enter the partner's share of the partnership's long-term Section 1231 gain or loss multiplied by the apportionment percentage in Form 3, line 30.

The correct Massachusetts amount of the partner's share of long-term Section 1231 gain or loss may differ from the comparable U.S. total reported on your Form 1, 1-NR/PY, 2 or 3F, Schedule D. Each partner should make adjustments in Form 1 or 1-NR/PY, Schedule D, Part 1, line 9, or Part 2, line 8 or Form 2, Schedule D, line 11 or Form 3F, Schedule D, line 6, to reflect the correct Massachusetts amount. Each partner should attach a statement with the partner's Massachusetts tax return and explain any adjustments.

Line 20. Long-Term Gains on Collectibles and Pre-1996 Installment Sales

Enter the partner's share of the partnership's long-term gains on collectibles and pre-1996 installment sales classified as capital gains for Massachusetts purposes from Form 3, line 24. For a nonresident partner eligible to apportion, enter the partner's share of the partnership's long-term gains on collectibles and pre-1996 installment sales multiplied by the apportionment percentage in Form 3, line 30.

The correct Massachusetts amount of the partner's share of long-term gains on collectibles and pre-1996 installment sales may differ from the comparable U.S. total reported on your Form 1, 1-NR/PY, 2 or 3F, Schedule D. Each partner should make adjustments in Form 1 or 1-NR/PY, Schedule D, Part 1, line 9, or Part 2, line 8 or Form 2, Schedule D, line 11 or Form 3F, Schedule D, line 6. Each partner should report the correct Massachusetts amount in Form 1 or 1-NR/PY, Schedule D, Part 1, line 11 or Part 2, line 10; Form 2, Schedule D, line 13 or Form 3F, Schedule D, line 8. Each partner should attach a statement with the partner's Massachusetts tax return and explain any adjustments.

**Corporate Partner Information
For Corporate Partner Only**

Complete lines 22 through 24 for corporate partners only. For **all other** partners, **skip** to line 25. Lines 22 through 24 isolate income and deduction items where there are differences between Massachusetts and federal tax treatment. The information provided in lines 22 through 24 should be used by each corporate partner to complete Schedule E of the appropriate corporate return, supplementing other information on the corporate partner that is derived from U.S. Forms 1065 and 1120.

Provide each corporate partner with the apportionment factors in Form 3, lines 26 through 28 to assist each corporate partner in completing Schedule F of the appropriate corporate return. A corporate partner's distributive share of any item of income, loss, deduction or credit is determined by the partnership agreement. If the partnership agreement contains no provision with respect to the partner's distributive share of any item of income, loss, deduction or credit, such item shall be prorated in accordance with each partner's ratio of sharing income or losses of the partnership.

Line 22. State and Municipal Bond Interest

Enter the corporate partner's share of the partnership's state and municipal bond interest. This income is not reported in U.S. net income, but **is** taxable in Massachusetts. Each corporate partner should include the line 22 total in Form 355, 355C or 355S, Schedule E.

Line 23. Foreign, State or Local Income, Franchise, Excise or Capital Stock Taxes

Enter the corporate partner's share of the partnership's foreign, state or local income, franchise, excise or capital stock taxes. These taxes are deducted from U.S. net income, but not deductible in Massachusetts. Each corporate partner should include the amount in line 23 on Form 355, 355C or 355S, Schedule E.

Line 24. Other Adjustments

Enter each corporate partner's share of any other adjustments to Massachusetts partnership income that reflect differences between Massachusetts and federal tax treatment of corporate partner income and deductions. The partnership should provide each corporation with the amount of the difference between the Massachusetts depreciation allowance and the federal "bonus" depreciation allowance. The partnership should also provide each corporate partner with the amount of the partner's share of the costs of renovating a qualifying abandoned building. Each corporate partner should use the line 24 amount in Form 355, 355C or 355S, Schedule E, line 7 through 10 and line 12, if applicable.

Reconciliation of Partner's Capital Account**Lines 25 through 29. Reconciliation of Partner's Capital Account**

Lines 25 through 29 must be completed for each partner.

Line 25. Balance at the Beginning of Year

Enter each partner's capital amount at the beginning of the year.

Line 26. Net Income for the Year

Line 26a must include all income subject to taxation to resident and nonresident partners. Line 26b must include all line 26 income plus all income not subject to taxation and must reflect unallowable deductions.

Line 29. Balance at the End of Year

Enter the sum of lines 25, 26b and 27 less the amount in line 28.

Where to Get Forms and Publications

Many Massachusetts tax forms and publications are available via the Internet. The address for DOR's website is www.mass.gov/dor.

To obtain Massachusetts forms and publications by phone, call the Department's main information lines at (617) 887-MDOR, or toll-free in Massachusetts at 1-800-392-6089. Please note that many forms and publications are available 24 hours a day by calling the Department's automated forms request system at the numbers listed above.

Certain forms and publications can be obtained through DOR's Fax on Demand system. For a complete Fax on Demand menu, please dial (617) 887-1900 using the handset and the keypad on your fax machine.

For General Tax Information

Please call (617) 887-MDOR or toll-free in Mass. at 1-800-392-6089.

For help in one of the following specific areas, please call the number listed below:

- Certificates of Good Standing (617) 887-6550
- Installment sales (617) 887-6950
- Small Business Workshop (617) 887-6400
- Teletype (TTY): (617) 887-6140
- Vision-impaired taxpayers are welcome to make an appointment at any DOR office listed on this page to receive assistance in preparing their tax forms.

To report allegations of suspected misconduct or impropriety involving Department of Revenue employees, please call the Inspectional Services Division's Integrity Hot Line at 1-800-568-0085 or write to PO Box 55480, Boston, MA 02205-5480.

Massachusetts

Department of

Revenue

PO Box 7011

Boston, MA 02204

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Dear Taxpayer,

Last year, more than one million taxpayers electronically-filed their state income tax returns in the Commonwealth and received refunds, on average, in four days. Unfortunately, many of those who filed paper returns did not receive their refund checks for three or more months. DOR is doing everything possible to streamline processing this year. Whether you use our popular telephone option, Telefile, or file using a DOR-approved commercial software package or tax preparer, the best way to guarantee a speedy refund is to e-file your return. If you need to make a payment, you can e-file early and have your electronic payment debited from your account as late as April 15th.

Please note that many DOR-approved tax preparation software packages this year will translate the line item entries on your return into a bar code so that we can more quickly process your return. For a list of authorized software packages with 2-D bar coding, please visit our website at www.mass.gov/dor.

Recent tax law changes have affected the tax rate, personal exemption, treatment of capital gains, employment-related child and dependent care deduction and Senior Circuit Breaker Credit. In addition, the Charitable Contributions deduction has been suspended. Please be sure to refer to the instructions in this booklet for guidance. For your convenience, DOR has reduced the amount of supporting documentation that needs to be enclosed with your return. Finally, new this year, you may report any use tax payments owed on out-of-state purchases directly on your income tax form rather than having to file a separate use tax return.

The staff at the Department of Revenue is committed to making this tax filing season as efficient as possible. For information or assistance, please visit our website or call us at (617) 887-MDOR or, toll-free in Massachusetts, (800) 392-6089.

Sincerely,



Alan LeBovidge
Commissioner